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December 13, 2005

VIA ELECTRONIC AND U.S. MAIL

Catherine Witherspoon
Executive Officer
California Air Resources Board
P.O. Box 2815
Sacramento, CA 95812

RE: Petition for public hearing on revisions to San Joaquin Valley Air Pollution Control District new source review rule (Rule 2201)

Dear Ms. Witherspoon:

On December 15, 2005, the Governing Board of the San Joaquin Valley Unified Air Pollution Control District will be asked to consider and approve revisions to the District's new source review rule (Rule 2201). These revisions are intended to incorporate and comply with "reforms" to the federal new source review regulations promulgated on December 31, 2002 (67 Fed. Reg. 80186). State law recognizes that these federal new source review reforms substantially weaken the federal new source review program. Cal. Health & Safety Code §§ 42500 *et seq.* (codifying SB 288, Sher (2003)). As a result, state law prohibits air districts from revising local new source review rules to incorporate the federal relaxations. Cal. Health & Safety Code § 42504. In order to effectuate this prohibition, state law outlines procedural requirements in section 42504 of the Health and Safety Code whereby the state air resources board is required to make a finding, after a public hearing, on the stringency of the revised or amended district new source review rules. This letter describes the illegal relaxations being made to San Joaquin Valley APCD Rule 2201 and formally requests a public hearing under Health and Safety Code section 42504 to consider the stringency impacts of these revisions.

General Requirements of Federal New Source Review

Federal new source review regulates the construction and modification of sources that result in significant increases of pollutants such as particulate matter, oxides of nitrogen and volatile organic compounds. New source review requires that such proposed construction be reviewed to ensure that the new or modified source will be subject to stringent emissions controls and that all new emissions will be offset by emission reductions from other sources in the area. In this way, new source review allows for growth in an area while still ensuring the area reduces emissions to achieve the national ambient air quality standards.

Of particular importance here is the federal requirement to offset emissions increases at these new or modified sources. The Clean Air Act ("CAA" or "Act") requires that emission reductions used to offset the emission increases at these new or modified sources be in excess (referred to as "surplus") of emission reductions otherwise required by the Act. CAA

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§ 173(c)(2). This surplus requirement prevents double counting the benefit of emission reductions and ensures that there is no net change in the inventory of emissions with the new source. Because emission reductions may occur well before they are used to offset emission increases at new or modified sources, federal law requires that the surplus value of emission reductions be determined at the time they are to be used as opposed to the time they were generated. See 69 Fed. Reg. 27837, 27840 (May 17, 2004). This requirement is commonly known as the "surplus-at-time-of-use" requirement.

SB 288 recognizes the importance of the federal offset requirements. Health and Safety Code section 42501 includes the following findings:

> (a) For over 25 years the federal Clean Air Act (42 U.S.C. Sec. 7401, et seq.) has required major new and modified sources of air pollution to be subject to a new source review program . . . in order to ensure that those sources use the requisite level of emission control, offset any new emissions, and comply with other requirements, as a means of ensuring that those new and modified sources do not adversely affect air quality.
> (b) Requiring controls and emission offsets from new and modified sources ensure that industrial growth does not result in unacceptable levels of air pollution and that existing sources operate more cleanly over time by applying emission controls when those sources are overhauled or upgraded. Without these limits, air quality would degrade over time, and industrial growth, critical to the economic health of the state would be foreclosed.

While the emission control requirement in new source review ensures that sources achieve improved rates of emissions control, it is the federal offset requirement that prevents air quality in nonattainment areas from getting worse and thereby protects the ability of these areas to grow economically. Federal new source review is triggered where emissions will significantly increase even with the addition of controls. As a result, the offset requirement is key to the successes in nonattainment areas highlighted in the findings of SB 288.

The reforms to the federal new source review regulations adopted December 31, 2002 relax the stringency of the federal rule by allowing more types of modifications to escape new source review. The reforms include new criteria and exemptions for determining what changes to a source will be considered major modifications. The result is that a number of modifications that would have been subject to federal emission control requirements and the requirement to offset emissions, will now only need to comply with local rules governing minor modifications. In many California air districts this may not be a significant change because the local rules governing minor modifications may include requirements that are just as stringent as the federal requirements. This, however, is not the case in San Joaquin Valley.

San Joaquin Valley APCD Rule 2201

The San Joaquin Valley APCD has had a difficult time adopting a new source review rule that complies with the federal requirements as amended by Congress in the 1990 Clean Air Act Amendments. These amendments required existing nonattainment areas to revise their programs accordingly by 1992, see, e.g., CAA §§ 182(a)(2)(C) and 189(a)(2), but San Joaquin did not

receive full EPA approval until May 17, 2004. 69 Fed. Reg. 27837. The chief stumbling blocks were the District's requirements for emission reductions used to offset emissions at new and modified major sources.

EPA has found the District rules for offsets were less stringent than the federal requirements in several respects. See 68 Fed. Reg. 7330, 7332-33 (Feb. 13, 2003) (noting failure to require all emissions to be offset, failure to apply minimum federal offset ratio in all cases, and failure to determine surplus value of emission reductions at the time they are used as offsets). The District, however, maintained that in other respects the District offset requirements were more stringent than federal requirements such that, in the aggregate, just as many emission reductions would be required for major sources under the District rules as would be required under the federal rules. Rather than change Rule 2201 to match the federal offset requirements, the District promulgated an offset equivalency tracking system to support the District's claim.

To receive EPA approval of this offset equivalency tracking system, the District had to include a mandatory and enforceable remedy to cure any shortfall identified in the annual equivalency demonstration. See 66 Fed. Reg. 37587 (July 19, 2001). After some back and forth between EPA and the District, the District finally adopted the necessary revisions to the equivalency tracking program on December 19, 2002. EPA approved these revisions into the SIP on May 17, 2004. See 69 Fed. Reg. 27837.

The remedies added to Rule 2201 require the District to retire banked emission reduction credits or to impose more stringent "surplus-at-time-of-use" requirements if the District discovers that sufficient creditable offsets have not been required in a given year. Fear of triggering these remedies has forced the District to be more selective in approving the credits used as offsets in specific permits issued under new source review. This desire to avoid triggering these mandatory remedies is also the reason the District is seeking to relax Rule 2201 to make it easier to demonstrate offset equivalency.

At the time the District adopted the final revisions to the equivalency tracking program, EPA had already signed the reforms to the federal new source review regulations that would be published in the Federal Register on December 31, 2002. The District and EPA knew what changes would be made to the federal rules but insisted that the District equivalency program compare the offset requirements of Rule 2201 to the "pre-reform" federal offset requirements. As a result, the equivalency provisions in section 7 of Rule 2201 specified that the offset comparison would be to the federal regulations in effect on December 19, 2002.

The revisions to Rule 2201 proposed for adoption at the upcoming Board hearing address several changes that are necessary to meet EPA's requirements under the federal new source review reforms. Most of these changes do not affect the stringency of Rule 2201 because the same requirements will continue to apply to sources even if they are no longer considered major modifications under the federal rules. In addition to these required changes, however, the District has proposed a wholly unnecessary change to the equivalency provisions in section 7 of Rule 2201. The revisions would delete the December 19, 2002 date used to specify that the offset comparison must be to the pre-reform version of the federal regulations. Nothing in the federal rules compels this change. It is being made solely for the purposes of relaxing the offset

requirements in Rule 2201. With this change the District will be able to take advantage of the relaxations in the federal rules by requiring only as many creditable offsets as would be required under these new more lax federal rules. This is the very type of relaxation in district rules that SB 288 was intended to prohibit.

Requirements of SB 288

Among the legislative findings of SB 288 outlined in Health and Safety Code section 42502 is the State's conclusion that, "Any rollback of the new source review program, as a result of the federal 'reforms,' would exacerbate the continuing air pollution challenges faced by the state and delay attainment of the state and federal ambient air quality standards." Cal. Health & Safety Code § 42502(g). To prevent such rollbacks, section 42504 provides flatly, "No air quality management district or air pollution control district may amend or revise its new source review rules or regulations to be less stringent than those that existed on December 30, 2002." Cal. Health & Safety Code § 42504(a). The law specifies that, "For purposes of this chapter, each district's 'existing new source review program' is comprised of those new source review rules and regulations . . . that have been adopted by the district governing board on or prior to December 30, 2002, that have been submitted to the U.S. Environmental Protection Agency by the state board for inclusion in the state implementation plan and are pending approval or have been approved by the U.S. Environmental Protection Agency." Cal. Health & Safety Code § 42505.

Sections 42504(b) and (c) set an even higher hurdle for changes to any definitions, applicability procedures or calculation methodologies that would have the effect of relaxing or reducing a source's obligation to meet the following new source review requirements:

> (A) Any requirements to obtain new source review or other permits to construct, prior to commencement of construction.
> (B) Any requirements for best available control technology (BACT).
> (C) Any requirements for air quality impact analysis.
> (D) Any requirements for recordkeeping, monitoring and reporting in a manner that would make recordkeeping, monitoring, or reporting less representative, enforceable, or publicly accessible.
> (E) Any requirements for regulating any air pollutant covered by new source review rules and regulations.
> (F) Any requirements for public participation, including a public comment period, public notification, public hearing, or other opportunities or forms of public participation, prior to issuance of permits to construct.

Cal. Health & Safety Code § 42504(b)(2). Unlike the general prohibition in subsection (a) of 42504, which only prohibits changes that are less stringent, subsection (c) requires that changes to the district rules that might affect the new source review requirements specified in subsection (b) are only allowed if the changes are more stringent than the requirements that existed on December 30, 2002. Cal. Health & Safety Code § 42504(c).[1]

[1] ARB's August 2004 guidance on SB 288 suggests that 42504(b) "clarifies" the general prohibition in 42504(a) "by specifying the components or elements of a District's NSR rules to which it pertains . . . ." California Air

Notwithstanding the requirements in subsections 42504(a), (b) and (c), certain relaxations may be allowed in a limited number of situations. Cal. Health & Safety Code § 42504(d). Under section 42504(d), "a district may amend or revise a rule or regulation if [1] a district board, at the time the amendments or revisions are adopted, makes its decision based on substantial evidence in the record, [2] the amendments or revisions are submitted to and approved by the state board after a public hearing, and [3] each of the . . . conditions [in section 42504(d)(1) through (4)] is met . . . ." Cal. Health & Safety Code § 42504(d). The conditions outlined in section 42504(d)(1) provide a narrow set of justifications for revising the district new source review requirements. These include:

(1) Replacing an existing rule that causes a risk to public health;

(2) Replacing an existing rule that has been found unworkable due to engineering or other technical problems;

(3) Replacing an existing rule that causes substantial hardship to a business, industry or category of sources;

(4) Temporarily replacing a requirement in order to respond to an emergency; or

(5) Replacing a rule in an area that is attaining the national ambient air quality standards if the change will not impair or impede the ability of the area to maintain these standards.

Only in these limited circumstances can the district change the requirements specified in 42504(b) without making the requirement more stringent or change any other new source review requirement such that it is less stringent than the requirement existing on December 30, 2002.

SB 288 outlines two important roles for the state board in overseeing changes to district new source review requirements. Both, by necessity, require the state board to evaluate and make findings on the stringency of changes to district new source review rules. Section 42504(a) provides, "If the state board finds, after a public hearing, that a district's rules or regulations are not equivalent to or more stringent than the rules or regulations that existed on December 30, 2002, the state board shall promptly adopt for that district rules or regulations that may be necessary to establish equivalency, consistent with subdivision (b)." Cal. Health & Safety Code § 42504(a). This section is intended to cover inadvertent relaxations resulting from district

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Resources Board Guidance, New Source Review and Senate Bill 288 ("SB 288 Guidance") at 2 (Aug. 2004) (emphasis in original). While the ultimate conclusion of the SB 288 Guidance is consistent with our conclusion here – that changes to the "surplus at time of use" requirement for offsets are only allowed if they meet the requirements of section 42504(d) – the conclusion that section 42504(b) merely clarifies 42504(a) is not based on a satisfactory reading of the statute. First, it would render the prohibitory language in subsection (a) superfluous. Second, it fails to give meaning to the different standards provided in subsections (a) (may not be "less stringent") and (c) (must be "more stringent"). Third, it reads subsection (b) as defining the terms of subsection (a) with no such express language despite examples in the law that the legislature knew how to provide such express definitions. See, e.g., Cal. Health & Safety Code § 42505 (defining "existing new source review program" as used in 42504(a)). Finally, this interpretation would collapse subsections (a) and (b) even though other sections in the statute clearly treat them separately. See, e.g., Cal. Health & Safety Code §§ 42504(c) (referring only to changes covered by subsection (b)) and 42504(d) (providing an exemption to both subsections (a) and (b)).

changes to the new source review regulations and allows for the state board to fix these problems. See SB 288 Guidance at 4. By contrast, section 42504(d) covers deliberate relaxations adopted by a district and calls on the state board only to approve or disapprove the changes. Cal. Health & Safety Code § 42504(d). This letter describes the specific procedural requirements that should be applied to the District's revisions of Rule 2201 after analyzing the applicability of the SB 288 prohibitions to these revisions.

Analysis of Revisions to Rule 2201 Under SB 288

There is no dispute that the revisions to the offset equivalency requirement in section 7 of Rule 2201 will relax the offset requirements contained in the District's new source review rule as it existed on December 30, 2002.[2] The intended effect of these changes is to allow the District to demonstrate the equivalency of its offset requirements to the less stringent requirements under the new federal regulations. Under the new federal rules, fewer modifications will trigger federal requirements including the requirement to obtain offsets meeting federal creditability criteria such as the "surplus at time of use" criterion. As a result, the District will not need to require the same number of creditable offsets in the aggregate to demonstrate equivalency to the new federal program.

These revisions to section 7 of Rule 2201 are not required by any provision in the federal regulations. These are not changes that are intended to accomplish some other goal and inadvertently relax the rule. These changes are intended to undo the prior deliberate decision to require that the District show that its offset provisions were equivalent to those in the more stringent version of the federal regulations. The purpose of these changes is to take advantage of the relaxations to the new source review program adopted by EPA.

Such deliberate relaxations are only allowed if the criteria in section 42504(d) are met. There is no claim by the District that the rule is necessary to address a public risk, temporarily relieve a particular hardship, replace infeasible requirements or meet any of the other special circumstances outlined in section 42504(d)(1). The state board, therefore, could not approve these revisions under section 42504(d).

The District's only argument for allowing these changes under SB 288 is that SB 288 did not intend to preserve the stringency of district new source review offset requirements. The argument relies on the belief that only those elements expressly listed in section 42504(b) are subject to the anti-backsliding requirements.

This argument is inconsistent with both the statutory language and the legislature's express findings on the need for SB 288. It is also an interpretation that is at odds with ARB's SB 288 Guidance.

[2] The offset equivalency provisions in section 7 of Rule 2201 are part of the District's "existing new source review program." They were adopted by the District governing board on December 19, 2002. They were submitted to EPA for inclusion in the state implementation plan by the state board on December 23, 2002. EPA found the submittal complete on December 30, 2002 and approved these provisions into the state implementation plan on May 17, 2004.

As explained above, section 42504 includes a broad prohibition in subsection (a) that prohibits any amendments or revisions that lessen the stringency of a district's new source review rules. Subsection (b) does not purport to define this broad prohibition but instead establishes a list of new source review requirements that are subject to a separate standard in subsection (c). Changes to the elements listed in subsection (b) may only be made if they make the rule more stringent than the existing rule. Cal. Health & Safety Code § 42504(c). To read subsection (b) as merely defining the scope of the broad prohibition in subsection (a) would render the broad prohibition meaningless and superfluous. It also creates the potentially absurd result where the state allows a revision under subsection (a) after finding that the revised rule is equivalent to the existing rule but must reject it under subsection (c) because it is not more stringent. The only way to resolve the differences between the treatment of subsections (a) and (b) is to read subsection (b) as defining a subset of the changes covered by subsection (a).

ARB's SB 288 Guidance comes to a similar conclusion albeit through a slightly different line of reasoning. The Guidance explains, "While some NSR program changes do not directly contradict any of the criteria set forth in 42504, they may allow or enable rule weakenings that could not occur 'but for' the revision. The ARB's view is that such indirect backsliding is not permitted by the Act." SB 288 Guidance at 5. The Guidance then proceeds to identify a number of possible changes not expressly enumerated in section 42504(b) that can only be made "if the amendment complies with the criteria set forth in section 42504(d)." Id. The examples provided include decreases in offset ratios and "[c]hanges to the requirement that 'surplus' must be verified at the time of use of the offsets." Id. Thus, even under ARB's more narrow reading of the statute, the changes to Rule 2201 that relax the requirement for offsets to meet the federal "surplus at time of use" criteria would not be approvable because the changes do not satisfy the provisions in section 42504(d).

The ARB comes to its statutory interpretation from the undeniable conclusion that the legislature was concerned about preserving more than just the new source review elements listed in section 42504(b). In particular, the legislature makes repeated findings on the critical importance of the new source review offset requirement and could not have intended to exclude this requirement from the anti-backsliding provisions of SB 288. See, e.g., Cal. Health & Safety Code §§ 42501(a) and (b), 42502(c) and (e).[3] As explained above, it is the offset requirement that is key to the new source review program's ability to prevent degradation of air quality in nonattainment areas and to preserve the ability of these areas to have continued economic growth. If the anti-backsliding provisions of SB 288 do not cover the offset requirement, the purposes outlined in these legislative findings would not be met. If districts are allowed to relax offset requirements to take advantage of the federal new source review reforms, new and modified sources, even though subject to stringent emission controls, will add to the overall emissions inventory in the area and contribute to degradation of air quality.

[3] ARB's SB 288 Guidance also repeatedly notes the importance of the offset requirement and explains, "If the revised federal program were to be implemented in California, the requirements for technological and operational emissions control and emissions offsets that ensure modified sources do not adversely affect air quality would be undermined." SB 288 Guidance at 1 (emphasis added).

The proposed revisions to Rule 2201 violate both the letter and the spirit of SB 288.[4] With these changes, the District's new source review rule will be deliberately weakened from the regulations that existed on December 30, 2002. The result will be to require fewer creditable emission reductions to offset emissions increases from new and modified sources. This decision to take advantage of the relaxations to the federal program will undermine the air quality protections that have been achieved by the existing new source review regulations and allow air quality in the area to degrade. The state board should disapprove these changes to Rule 2201 in accordance with the procedures outlined below.

Required State Action

Upon District Board approval and submittal to ARB of the changes to Rule 2201, the state board should hold a public hearing to make a finding on the stringency changes to the rule and take the appropriate action required under SB 288. The provisions in both subsections (a) and (d) of Health and Safety Code section 42504 appear to allow for state board action on individual changes to the district new source review rules. Disapproval of the specific revisions to the offset equivalency program therefore may not require disapproval of all other changes to Rule 2201. Because the remedy under either subsection (a) or (d) would be to disapprove the proposed changes to section 7 of Rule 2201 in order to retain the existing regulatory language, there is no need to have separate hearings under each of these provisions.

For the reasons outlined herein, we request that the state board initiate a public hearing in accordance with Health and Safety Code sections 42504(a) and (d) promptly upon receipt of the December 15, 2005 revisions to San Joaquin Valley Rule 2201. In calling for the public hearing, the state board should propose to find that the changes to section 7 of Rule 2201 constitute a relaxation of the District's new source review regulations existing on December 30, 2002 as prohibited by Health and Safety Code section 42504(a), and that such relaxation cannot be approved under the criteria provided in Health and Safety Code section 42504(d).

Thank you for your attention to this important matter. If you have any questions, please do not hesitate to call me at (510) 550-6777.

Sincerely,

Paul Cort
Staff Attorney

Cc: Tom Jennings, Chief Counsel, CARB
David Crow, Air Pollution Control Officer, SJVUAPCD
Deborah Jordan, Air Division Director, U.S. EPA

[4] See SB 288 Guidance at 4 ("Proposed revisions to the District NSR programs will be reviewed in the context of the letter and the spirit of the Act.").